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UNCLAS SECTION 01 OF 03 RIO DE JANEIRO 000019

SIPDIS

BUENOS AIRES FOR M.HAARSAGAR
STATE PASS OPIC FOR RGREENBURG, DMORONESE
STATE PASS EXIM FOR NATALIE WEISS, COCONNER
STATE PASS USTDA FOR AMCKINNEY
TREASURY FOR FPARODI

E.O. 12985: N/A

TAGS: [EINV](#) [ECON](#) [EFIN](#) [BEXP](#) [BR](#)

SUBJECT: Brazil - Bahia State Growing Faster but Interior
Still a Problem

Ref: 2003 Rio de Janeiro 1773

Summary

1. While the State of Bahia has the sixth largest GDP in Brazil and expected growth of 8.6% in 2004, the concentrated nature of Bahia's economy - both in terms of geography and industry - is a challenge for state authorities. In response, the State has developed several special programs designed to attract investment and address issues such as poverty and infrastructure bottlenecks. The most obvious success story to date is the Ford plant in Camacari; most believe the state-conceded incentives were more than worth it for the positive impact on the State's image alone, allowing Bahia to attract future investments at a much lower cost. As for the future, several new investments are expected to come on-line in 2006 and tourism - while still a relatively small part of the state's economy at 4% of GDP - is on the rise. However, while these programs and investments may help the coastal region, curing the ills of Bahia's interior - and its consequent poverty - will not be easy.

A Concentrated Economy Poses Challenges

2. While the State of Bahia has the sixth largest GDP in Brazil (4.7% of the national GDP in 2002) and an estimated growth of 8.6% in 2004, the concentrated nature of Bahia's economy - both in terms of geography and industry - is a challenge to overcome. The developed coastline relies on a few sectors such as petrochemicals and agribusiness; cellulose, petrochemicals and the automotive industry account for 40% of the State's GDP. In the far western part of the state, the economy resembles that of Brazil's center-west - where soy is king - and is doing well; Cargill has a presence there and irrigated fruit farming is on the rise. However, Bahia's largely semi-arid interior is very poor and is sustained primarily by transfer payments from the federal and state governments, e.g., retirement payments and automatic transfers to municipalities.

3. Curing the ills of Bahia's interior will not be easy and, according to Bahia's State Development Agency (Desenbahia) President Vladson Menezes, there is no consensus among state economic authorities on an approach. Menezes told Rio econoff that he thinks that the State should try to stimulate what little economic activity already exists in these places, i.e., fruticulture, irrigated crops, cotton and castor oil. Castor oil could take on more importance as Bahia's biodiesel program (sponsored by the state and federal government) gets up and running (Note: Bahia is the largest producer of castor in Brazil, accounting for 80% of Brazil's national production.)

Long-Term Development Plans

4. Bahia's sound financial situation (ref A) and fiscal adjustment program have enabled the State to develop several programs designed to attract investment. The first program was "Pro-Bahia," which began to offer fiscal incentives, such as reduced or prolonged payment of ICMS taxes, as early as 1991; at the time, Bahia was one of the few states that could afford to engage in this so-called "fiscal warfare." The Pro-Bahia program, combined with Bahia's proximity to the southeast consumers, helped to attract various investments throughout the 1990's. Over the last few years, the program has progressed from a generic incentive program to a targeted sectorally based program, and was used to differing levels of success in developing an informatics pole in Ilheus and an automotive sector in Camacari.

5. The State currently has a plan called Bahia 2020, which is a statewide program for meeting certain Human Development Index goals. Another key plan for the State's economic development is "the State Plan for Transport Logistics," which is based on a study on the flow of goods throughout

the state and is meant to be a basis on which state economic authorities can rationalize scarce resources to better target infrastructure projects that will benefit the State most. The idea is that the private sector would most readily partner with the State in these priority areas, with or without public-private sector partnerships (PPPs); Bahia also has approved a law regulating PPPs.

Ford Plant Was Worth Every Penny...

16. The most obvious example of the success of Bahia's incentive programs is the location of the Ford plant in Camacari, Bahia, after negotiations broke down with the state of Rio Grande do Sul and then Governor Olivio Dutra. Most interlocutors in Bahia told econoff that the financial sacrifice that Bahia made to attract the Ford plant was well worth it for the positive impact on the State's image alone, which should allow the State to attract future investments at a much lower cost. In addition, the USD 1.9 billion operation, which opened in Camacari in October 2001, has had a considerable socioeconomic impact on the surrounding area, exceeding initial expectations and creating 7,000 direct jobs and 70,000 indirect jobs. (Reftel) The State also received a Ford Design Center as a result of contractual commitment for engineering services, bringing 400 engineers from Sao Paulo and abroad. (Note: This is Ford's only design center in Latin America; there are only four others in the world.)

17. However, Bahia did "spend" a lot to attract the Ford plant to Bahia, including conceding Ford a state-constructed private port for 20 years, leveling the land, guaranteed interest rate stability, some direct financing and tax deferments, in addition to several public works required by Ford for a minimum quality of life for its workers. The burden got to be too much with the unforeseen spike in interest rates in 2002 and 2003 and Bahia was forced to "renegotiate" with Ford in 2003, essentially doing a bit of number juggling and adjusting the payment calendar, which allowed the State to evade mandatory spending and transfers to municipalities with the stroke of a pen.

New Investments on Horizon

18. Indeed, Bahia's "business friendly" attitude seems to be paying off in other areas, with several new investments coming on-line in 2006. A newly announced Bridgestone tire plant, which represents an initial investment of USD 270 million, should come online in 2006; a cellulose investment in southern Bahia by Veracel in conjunction with a Swedish company also is expected to come online the same year. Additionally - to the annoyance of Rio state authorities - Bahia will get a brand new shipyard 300-400 km south of Salvador courtesy of the Bahian construction company Odebrecht, which has won several contracts for the construction of deep-water production platforms for Petrobras.

19. That said, Menezes confided that he thinks that the State still lacks a deliberate articulation of its priorities. Jobs are a high priority for the State, yet many of the large companies installed in Bahia do not create a lot of local jobs; the State's principal industries contribute 40% of the GDP but only 17% of the jobs in the market. Menezes thinks the State needs to focus on the creation of local Small and Medium Enterprises (SMEs) around these "anchors" to employ more Bahians, adding that Salvador has the highest unemployment (15.8%) of Brazil's six principal metropolitan areas, according to the IBGE.

Despite Focus, Tourism Still in Initial Stages

10. State and city authorities alike also are focusing hard on the potential economic impact of increased tourism, despite the fact that it still represents a relatively small part of the state's economy -- estimated at 4%-8% of the State's GDP. (Comment: Menezes estimates the real number is closer to 4% and blames the lack of English speakers and qualified workers for the industry, as well as a lack of advertising. End Comment.) That said, tourism is definitely on the rise; spending by tourists was up 10% year-over-year in the first 9 months of 2004 and there has been a significant increase in the number of tourists traveling to Bahia in the last 6-8 years. A number of joint ventures between local and international hotels have raised the overall quality level of lodging available; Menezes also sees this as positive because he opines that Bahia will get more attention from tourists as part of the information channels of big hotel chains.

11. State authorities recently decided that the State tourism agency was too focused on Carnival, to the detriment of general tourism, and are refocusing efforts to attract

tourists all year round. Authorities also are focusing on the Unites States' African-American community as a target; Bahia has one of the most vibrant Afro-derived cultures in the world and has a multimillion-dollar marketing campaign aimed at African-Americans who want to get closer to their African roots but may find Africa too distant, expensive or dangerous. Bahia's state tourism agency estimates that 60% of the 45,000 Americans who visited the region in 2002 were African-American.

Atkins